



## TAX COMPLIANCE GUIDE FOR FREELANCERS AND BUSINESS OWNER

### MODULE 5

### **LESSON 3:**

# COMMON PITFALLS THAT LEAD TO PENALTIES





# **Module 5. Staying Compliant and Avoiding Penalties**





# Lesson 3. Common Pitfalls That Lead to Penalties





### 1. The Cost of Non-Compliance

Failure to comply with tax regulations in the Philippines can result in significant penalties. These penalties often come in the form of:

**Surcharges:** A 25% surcharge is applied for failure to file a tax return, late filing, or underreporting of income.

**Interest:** The BIR imposes a 12% annual interest on unpaid taxes from the due date of the tax until fully paid.

**Compromise Penalties:** These are administrative penalties that can vary based on the type of tax violation, often imposed for first-time or unintentional errors.

Let's go over the common mistakes that lead to these penalties and how you can avoid them.



## 2. Common Mistakes That Lead to Penalties

### a. Late Filing of Tax Returns

One of the most common mistakes is **missing tax filing deadlines**. The BIR requires quarterly and annual tax filings, and failing to meet these deadlines can result in surcharges and interest on unpaid taxes.

**Quarterly Income Tax Return (BIR Form 1701Q)** is due:

**1st Quarter: April 15**

**2nd Quarter: August 15**

**3rd Quarter: November 15**

**Annual Income Tax Return (BIR Form 1701)** is due on **April 15** of the following year.



## 2. Common Mistakes That Lead to Penalties

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## 2. Common Mistakes That Lead to Penalties

### How to avoid this mistake:

Set up a **Tax Compliance Calendar** (as discussed in the previous lesson) with reminders at least one week before each deadline. This ensures you have enough time to gather documents, calculate taxes owed, and file on time.

### Example:

If you're a freelance graphic designer, missing the April 15 deadline for your first quarterly income tax return could result in a 25% surcharge on the tax you owe, plus an additional 12% interest per annum until it's paid. By setting up a calendar with multiple reminders, you can prevent this.



## 2. Common Mistakes That Lead to Penalties

### b. Underreporting Income

Another common pitfall is underreporting your income. Whether intentional or not, failing to report all sources of income can trigger penalties and audits. Freelancers often make this mistake when they have multiple streams of income or receive payments in cash.





## 2. Common Mistakes That Lead to Penalties

### How to avoid this mistake:

Track all payments from clients and customers, whether they are received via bank transfer, PayPal, or in cash. Use accounting software to automatically record these payments, and reconcile them monthly with your bank statements to ensure nothing is missed.

### Example:

If you receive payments via both bank deposits and GCash, but forget to report your GCash income, the BIR may find this discrepancy in an audit. By reconciling your bank and mobile payments monthly, you can ensure that all income is properly reported.



## 2. Common Mistakes That Lead to Penalties

### c. Incorrect Tax Deductions

Freelancers are entitled to various deductions, such as for business expenses, but claiming ineligible or inflated deductions can lead to penalties. For instance, you cannot claim personal expenses (like groceries) as business expenses, and inflating deductions can trigger a BIR investigation.



## 2. Common Mistakes That Lead to Penalties

### How to avoid this mistake:

Be sure to separate personal and business expenses and only claim deductions that are directly related to your business. Keep clear records of all receipts and ensure that you are familiar with the BIR's guidelines for what qualifies as a legitimate deduction.

### Example:

If you buy a new laptop for your business, that's a legitimate deduction. But if you try to claim personal travel expenses or meals as business deductions without proper documentation, the BIR may reject those claims and penalize you.



## 2. Common Mistakes That Lead to Penalties

### d. Failure to Pay Estimated Taxes

Freelancers are required to pay estimated taxes quarterly based on their projected annual income. Many freelancers either fail to make these quarterly payments or underpay, leading to penalties at the end of the year when they file their annual returns.



## 2. Common Mistakes That Lead to Penalties

### How to avoid this mistake:

Estimate your quarterly tax payments based on your income for the previous quarter, and set aside a percentage of each payment you receive for taxes. Regularly review and adjust your tax savings if your income changes.

### Example:

If you earned ₱300,000 in the first quarter and your estimated tax liability is ₱30,000, you should make a tax payment of that amount by the April 15 deadline. Missing this payment could result in penalties later when you file your annual return.





## 2. Common Mistakes That Lead to Penalties

### e. Incomplete or Inaccurate Record-Keeping

Keeping incomplete or inaccurate financial records is a common mistake that leads to filing incorrect returns. Missing receipts, incomplete income records, and failing to track expenses accurately can result in penalties if your tax filings don't match your actual financial activity.



## 2. Common Mistakes That Lead to Penalties

### How to avoid this mistake:

Use accounting software to track all income and expenses. Set aside time each week or month to reconcile your financial records and ensure everything is accurate. As discussed in the previous lesson, maintaining both digital and physical copies of receipts and invoices is essential.

### Example:

Let's say you forget to record a large payment from a client and underreport your income. When the BIR audits your records and discovers this payment, you could face penalties for underreporting income, plus interest on the unpaid tax.



## 3. Best Practices for Avoiding Penalties

Here are some best practices you can follow to avoid the common pitfalls we've discussed:

- 1. Set Reminders for Deadlines:** Use calendar apps to set automatic reminders for filing and payment deadlines at least one week in advance.
- 2. Track Income and Expenses Weekly:** Regularly update your records so that you're not scrambling to find documents at the last minute.
- 3. Reconcile Bank Accounts Monthly:** Compare your bank statements to your financial records each month to ensure accuracy.
- 4. Keep Clear Documentation:** Store both digital and physical copies of receipts, invoices, and tax filings for at least three years in case of an audit.



# Key Takeaways



1

**Late filing** or missing deadlines is a common pitfall, but setting up a tax compliance calendar can help you avoid this.

2

**Underreporting income** and making **incorrect deductions** can lead to penalties, so make sure to track all sources of income and accurately categorize business expenses.

3

**Reconcile your accounts regularly** and maintain organized financial records to prevent mistakes in tax filings.



# Learning Activity

**Review your last quarter's income and expenses** to ensure that all transactions were accurately recorded and categorized.

**Set up reminders** for your next tax filing deadline, including a reminder to pay your quarterly estimated taxes if applicable.

**Review your recent deductions** to ensure they are all legitimate business expenses and backed up by receipts or invoices.





# What's Next?

In the next lesson, we'll discuss Responding to BIR Audits, where you'll learn how to prepare for a BIR audit, what documents to gather, and how to respond professionally. Stay tuned for Lesson 4 of Module 5!



